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Towards a strategy for pro-poor growth in South-Eastern Europe

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Towards a strategy for pro-poor growth in South-Eastern Europe

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Abstract

In order to qualify economic growth as "pro-poor", at least per capita income-growth rates of the poor should be larger than the corresponding growth-rates of the non-poor resulting in a lower degree of distributional inequality. Measured in this sense, economic growth in South-Eastern Europe during the last 10-15 years was not pro-poor but pro-rich. Future growth can be changed towards the "pro-poor"-goal through a strategy with two "legs": Stimulation of overall growth and specific programs to make economic growth "pro-poor". Overall growth can be stimulated by good governance, macro-economic stability and the establishment of competitive markets. Specific programs should be focussed on sectors the poor work in (mainly agriculture), on regions the poor live in (mainly rural areas) and on the demand for factors the poor possess or are able to possess (labour). The paper discusses some elements of rural development, the possibilities of stimulating the demand for labour, and the necessary steps to improve the access of the poor to education and health-services. In addition to that, the problems of "pockets of poverty" are being discussed. A consistent strategy like this requires political decisiveness and administrative competence. It is hard to imagine that it can be materialized without giving the poor "voice" to influence the institutions and policies that affect their lives.

1. Some conceptual issues and empirical results

The term "pro-poor growth" has been frequently used in official documents of national governments and international organisations. But its meaning is far from being clear. I don't want to discuss here all conceptual issues[1]. But some remarks about the relevant concepts are unavoidable.

In the context of "pro-poor growth", poverty usually means "**income-poverty**", measured by the headcount index or the povertygap (the percentage of total population living below a certain poverty line and the aggregate distance of the poor's income from this line respectively). Measured in this way, the degree of income-poverty essentially depends on the location of the poverty line, or in other words: on the definition of the minimum income (or consumption) for a household or an individual not to be considered as poor. An internationally widely utilized poverty line is 1 US-$ a day per capita measured in purchasing power parity. Corresponding to this line, 2 % of Albania's total population have been poor in 2002 – following the country's Millenium Development Goal-Profile.[2] The World Bank's poverty assessment on the same country choose a different definition. People are considered poor if they earn less than 4 891 Leks per month (which is a bit more than 1 US-$ a day per capita). Measured against this limit, 25 % of total population have been considered poor in 2002.[3] Obviously the definition of the poverty line – and, of course, the sophistication of the underlying statistical procedure – is crucial for measuring income-poverty.

Another point should warn us of uncritically interpreting the commonly used indicators. Neither the headcount index nor the poverty-gap says anything about the **income distribution** below or above the poverty-line. The poor's income may be concentrated just below the line or alternatively their income may be widely spread. In the first case – illustrated by Croatia[4] - overall economic growth will reduce measured poverty much more than in the second case. On the other hand, if incomes of a large part of the non-poor are concentrated just above the poverty-line, an economic recession may considerably increase poverty which is less probable if incomes of the non-poor are widely spread. Bosnia-Herzegovina is a country in case. A

[1] *Lopez* (2004) gives an introduction into the definitional debate.
[2] *World Bank* (2004d).
[3] *World Bank* (2003a), p. XII.
[4] Poverty in this country is „shallow". On average the consumption of a poor household is 20,7 % below poverty line. See *World Bank (*2001), p. VII.

large part of the non-poor earn incomes close to the poverty line which makes them very vulnerable to any economic downswing[5].

Let me mention another point. **Non-income indicators** may give us a more realistic picture of poverty than income indicators do. Such indicators for example refer to the educational level of individuals, the housing conditions, the access to health services etc. In Bosnia-Herzegovina 27 % of adults can be considered "education poor" in the sense of not having finished primary education, and 29 % can be called "rights-poor", defined as belonging to households without established property rights for their housing[6] These are aspects of poverty which cannot be indicated by the income-concept.

Nevertheless, there is a **positive correlation** between changes in income- and non-income indicators of poverty. In general, any increase in overall income will improve the educational level of people, their state of health etc. because individuals can spend more for these purposes and/or because governments can afford more of social expenditures. The case, however, of the "rights-poor" in Bosnia-Herzegovina indicates, that certain aspects of poverty could be eliminated even without economic growth.

Income-poverty could not. Its decrease crucially depends on the overall economic growth. How strongly must poverty decrease in order to qualify economic growth as a "pro-poor" process? It does not make sense to apply the term to any process which mitigates poverty even in the slightest way. At least **per capita-income growth rates** of the **poor** should be **larger** than per capita income growth-rates of the **non-poor,** resulting in a **lower degree of distributional inequality**. This is no definition which complies with all requirements which can be formulated from a theoretical point of view[7], but it can serve as some kind of "thumb rule".

One should distinguish this concept from another one: the **elasticity of poverty to growth**, i.e. the percent change of the poverty rate divided by the percent change in the growth rate. An elasticity of 2 means that one percent point more GDP-growth (per capita) will reduce the headcount index by 2 percent points. It has been shown that this elasticity varies with the degree of initial inequality of income- and asset-distribution. The more equal income and

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[5] *World Bank* (2003b), p. II.
[6] Op. cit.
[7] Klasen, 2003, p. 3 f. formulates some theoretical requirements.

assets have been distributed initially, the higher the poverty-reducing effect of growth. This dependency in mind, *Ravallion* (2000, p. 17) suggested an "elasticity of poverty to the distribution-corrected rate of growth" which gives the following formula:

$$r = b(1-G)g$$

"r" being the annual percent change in the proportion of the population living in poverty, "g" being the growth rate of average income per capita, "G" being the Gini-Coefficient of income distribution and "b" the elasticity of poverty to the distribution-corrected rate of growth. Its estimated value is -4 (*Ravallion*, 2000, p. 18). The higher the Gini, the lower the poverty-reducing impact of a given growth rate. To take an example: The Gini for the Albanian income distribution has been estimated as 0,58[8], which is quite high. Given an annual growth rate of income per capita of 2 %, the Headcount Index will decrease by 3 percent points. In case of a more equal income distribution (say G=0,25), the poverty-reducing impact of the given growth-rate would be higher (6 percent points).

This, of course, is a mechanistic way of looking at the relationship between poverty-reduction and income-growth. It does not say anything about the underlying causalities and it does not allow qualifying a growth-process as "pro-poor" in the above mentioned sense. Nevertheless, the calculation of a poverty-elasticity of growth points to an important fact: it is **initial inequality** which determines the impact of growth on poverty[9].

Having discussed some conceptual issues and measurement possibilities the question arises: Can past economic growth in South-East Europe be qualified as "pro-poor"? In order to answer this question, one should calculate income-growth-rates of different brackets of the distributional pyramid and the corresponding changes of distributional patterns in all countries of the region. This is a big task, sufficient for a special research project. I must restrict myself to a more modest approach. As we have seen, growth may be qualified as "pro-poor" if in the course of growth income distribution becomes more equal implying larger growth-rates of the income per capita of the poor than for the non-poor.

There is no empirical evidence that income distribution has become more equal in South-Eastern-Europe. On the contrary! As far as comparable Gini-coefficients show, inequality has increased as a consequence of the transformation process (see table 1 with data for Bulgaria

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[8] *World Bank* (2003a), p. 33.
[9] The author discussed the relationship between equality and growth in *Sautter* (2002).

and Romania)[10]. For some years this process was characterized by negative growth rates. So there was no growth at all, even less a "pro-poor"-growth. Later on macroeconomic development recovered, in some countries in a remarkable way (figure 1). But even then the poor at best participated proportionately from growth, not to a disproportionate higher extent; there are no signs of a substantially decreasing inequality. In some cases (i.e. Romania in 2000-2002) episodes of high growth rates can also be characterized as periods of deteriorating equality which hampered the impact of growth on poverty.[11] All empirical evidence suggests: Economic **growth** in **South-Eastern Europe** during the last 10-15 years was **not pro-poor**, it rather was **pro-rich**. The poor benefited less from growth than the well-to-do. In most countries, poverty-rates increased and even where they recently declined, this reduction as a very modest one[12]. The question suggests itself: How can growth in the future made pro-poor? What are the elements of a strategy oriented to this aim?

2. Elements of a strategy for pro-poor growth.

"Pro-poor"-growth is first of all "growth". Economic activities in general should expand, overall income should increase. The **first** question, therefore, refers to the **determinants of overall economic growth** which can be influenced politically. Some of these determinants are neutral in terms of poverty-reduction or may even improve directly the opportunities of the poor to participate in economic growth. Some others may temporarily conflict with the goal of poverty alleviation. For example, a cut of public spending may be necessary in order to combat inflation as a prerequisite for sustainable growth. This can hurt the poor if the cut, for example, includes food subsidies. The same may be true for an exchange-rate devaluation. It stimulates export activities and growth but possibly increases food prices. The following discussion is focussed on "win-win"-constellations as there is large scope for corresponding measures. "Trade-off"-constellations between growth-stimulation and poverty-reduction in the short run will be discussed only cursorily[13].

[10] For other countries, there are no comparable data that could indicate the change of distribution in the course of time. But it can be assumed, that their distributional pattern showed a similar development.
[11] Romania's GDP growth of 5.3 percent in 2001 was one of the highest in Europe, but income distribution moved adversely for the poor, *World Bank* (2003d), p. 25.
[12] Headcount indices are just one indicator of poverty. *Mitev/Stubbs* (2004) give some information on social indicators.
[13] Literature on pro-poor growth shows, that there exist various trade-off situations, see *Lopez* (2004).

But the growth-process may only be called “pro-poor” if it is focussed on sectors the poor work in, on regions the poor live in and if it increases disproportionately the demand for factors the poor possess or are able to possess. The **second** question, therefore, refers to the possibilities to stimulate (a) the **sectoral and regional growth,** (b) the demand for **labour** (as the factor which can be supplied by the poor) and (c) the **education** as well as the **state of health** of the poor**.**

I’ll not discuss social policy issues as they are the topic of another session. It is self-evident that economic growth also improves the possibilities for public welfare programs. One may call them the **indirect** way to make the growth-process “pro-poor”. I’ll concentrate on the **direct** way, the disproportionate increase of production in sectors and regions the poor live in and the disproportionate increase of demand for factors the poor possess or are able to possess. The framework for this pro-poor growth is the stimulation of overall growth.

2.1. The stimulation of overall economic growth.

Theoretical knowledge as well as empirical evidence show us that overall economic growth can be stimulated through

a) Good governance,
b) macro-economic stability,
c) competitive markets[14].

ad a) Good governance. - Time is over in which international organizations, inspired by a very narrow interpretation of the so called “Washington consensus” (*Williamson*, 1990), propagated some kind of “minimal state”: as little government as possible. The new consensus is a “**strong but limited state”** (*World Bank*, 1997). “Strong” means: decisiveness of politicians in preparing and executing reforms, a transparent political decision-making process, an efficient public administration free of corruption, a sufficient independency of governmental authorities from private interest groups. That states have to be “limited” means: the executive is being efficiently controlled by the legislature, the “rule of law” governs politics, the government refrains itself from distorting market interventions. Following vast

[14] An overview on the institutional requisites for economic development gives *Sautter* (2004, pp. 290-308).

empirical evidence, these are fundamental prerequisites for any sustainable economic growth[15].

The **legacy** of the region is a different one and it would be unrealistic to expect that 10 or 15 years are sufficient to transform it completely (by the way: Meanwhile Germans think that it takes at least one generation to overcome their internal East-West-gap.) One has to be patient. However, it seems that some countries have been too patient. Their **transformation- process** has been delayed for several years (in Bulgaria reforms began only in 1997[16]), it was executed in a "stop and go"-manner (i.e. in Moldova and Romania[17]), it was severely obstructed by internal conflicts (i.e. in Serbia-Montenegro and Croatia[18]) and it has still to wrestle with unsolved problems of political identity (i.e. in Bosnia-Herzegovina[19]). The best one can say is that transformation has begun. It is a big challenge to continue it without further delay. There are numerous tasks which should be tackled. The following list is far from being complete:

- The **administrative fragmentation** of the country which impedes a free circulation of persons, goods and services has to be **overcome** (the special problem of Bosnia-Herzegovina[20]);
- the **civil service** should become more **merit-based** and **de-politicised**;
- the public **expenditure management** as well as the **tax administration** are highly inefficient and should be **modernized**;
- **human rights** as well as private **property rights** must be protected much more consequently (which does not mean, that the progress reached until now should be neglected; see table 2);
- **peace-keeping institutions** and **police forces** are challenged by post-conflict risks (i.e. minefields), by violence and criminality (one of the big problems of Bosnia-Herzegovina);
- the legal problems of **refugees, internally displaced people** and **asylum seekers** have to be solved[21];
- a fundamental **reform** of the **judicial system** should facilitate the "rule of law";

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[15] *World Bank* (1997, 2000b); *Leftwich* (1994); *Bardhan* (1990); *Alesina/Perotti* (1994); *Weder* (1999). *Khan* (2002) gives empirical evidence on the importance of political stability and continuity in economic reforms and policies comparing Malaysia with Pakistan.
[16] *World Bank* (2004a), p. 1.
[17] *International Monetary Fund and International Development Association* (2002); *World Bank* (2003c, 2004c).
[18] *World Bank* (2000a), *Federal Republic of Yugoslavia* (2001).
[19] *World Bank* (2003b).
[20] *World Bank* (2003b).
[21] Their number has been estimated to 470 000 and 660 000 for Bosnia-Herzegovina and Serbia-Montenegro and this amounts to 11.5% and 8.1% of total population respectively; *Mitev/Stubbs* (2004), p. 64.

- the **fight against corruption** as one of the main problems in all countries is imperative. In many statements of potential investors the widespread corruption is mentioned as one of the most severe obstacles for doing business in South-Eastern Europe. In the list of “Transparency International” in which countries are ordered corresponding to their “Corruption Perception Index”, the best rank of all South-European countries has Bulgaria (rank 55) and the worst one has Serbia-Montenegro (rank 109 out of 133 places, see table 3).

Steps in these directions are not only necessary for stimulating overall growth. They are also an indispensable element of a pro-poor growth-strategy. The poor are most hit by an non-transparent and corruptive administration, by violation of human rights, by the non-existence of an impartial judiciary etc. What is necessary, therefore, for stimulating growth in general is also necessary for any fight against poverty and vice versa. An effective protection of human rights, a corruption-free administration and functioning democratic institutions give the poor “voice” to influence policies. Without this “**empowerment” of the poor,** any strategy to improve their situation will fail.

ad b) Macro-economic stability. - One of the undisputable lections of the past economic performance of many developing countries is, that macroeconomic stability is a precondition of growth. Permanent high inflation rates divert economic activities from productive targets to more speculative ones, they undermine the capital market and distort factor allocation, they falsify price-signals and sooner or later they end in an economic breakdown. Therefore, sustainable growth of real incomes is not possible in an inflationary environment[22]. What is even more important in the context of pro-poor growth: The poor are disproportionately hit by rising prices (*Romer/Romer*, 1998). They cannot protect themselves through sophisticated money-market instruments and their market-power is too weak to compensate higher consumer-prices by higher factor-incomes. When an inflationary process finally ends in an economic breakdown, they suffer most of all. Macroeconomic stability, therefore, is a central element of a strategy for pro-poor growth[23].

Another lection from past experience is that unsustainable **fiscal deficits** are one of the main causes of inflations. Confronted with a weak tax-basis and aggravated by poor tax administrations, governments often take refuge in an “inflation tax” as an easy way to get

[22] This is one of the results of various empirical studies on pro-poor-growth, see *Lopez* (2004), p. 15.
[23] *Dollar/Kraay* (2000). Following these authors, monetary stabilization is a “super pro-poor”-policy (op.cit.p.5).

revenues. Other sources of government-induced inflations are deficits of State Owned Enterprises (SOE) and their compensation under the regime of a "soft budget constraint". These are typical features of a "**weak but over-extended state**" in contrast to the desirable "strong but limited state".

What all countries in the region inherited from the past was exactly this caricature of a polity. They still struggle to transform it and to harden the budget constraint – not without some success. In all countries the very high inflation which characterized the early years of transformation came to an end. In Croatia i.e. the annual price increase in 1993 was about 1300 percent. At present it is between 1 and 2 percent. Bulgaria, which started its transformation in 1997 with a 1000 percent inflation-rate, has achieved monetary stability. So in most countries macro-economic stabilization is a success story (table 4 and figure 2).

The most effective instrument was a **fixed exchange rate** as a nominal anchor of domestic money supply. Bulgaria and Bosnia-Herzegovina even established a **currency board** which is an extreme form of monetary self-binding[24]. Under this regime the Central Bank can no longer monetarize fiscal or quasi-fiscal deficits but it also looses its capacity to compensate internal or external shocks. Starting from high inflation rates, the nominal-anchor approach may be the only way to establish a "stabilization-culture" and to create confidence into the authorities of monetary policy.

However, it is a very **risky approach**[25]. The example of **Argentina** should warn us. For 10 years its currency board worked quite well and its creator *Cavallo* even tried to export it to other countries as the "Argentinian model". Meanwhile nobody would try to imitate the example of this country. What went wrong? It was not possible to control all fiscal and quasi-fiscal deficits. Prices for non-tradable goods increased, resulting in an appreciation of the real exchange rate and subsequently in growing deficits in the current account. When external creditors lost their confidence into the system, it broke down with severe consequences for the whole economy (*Stukenbrock*, 2004, p. 80-94).

Countries in South-Eastern Europe are not immune to these risks. Budgetary processes still are not very transparent and rational. Tax evasion is wide spread. The temptation to take refuge in an inflation tax is still present. Moreover, in some countries SOEs continue to

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[24] *World Bank* (2004a), p. 2; *Bosnia and Herzegovina, Council of Ministers BIH* (2003), p. 12.
[25] The risks are discussed in *Stukenbrock* (2004).

produce high deficits. **Macro-economic stability**, therefore, is not guaranteed. To **maintain** it may be even more difficult than it was to **gain** it (this is also the experience of many developing countries).

The challenge is to get a "**soft landing**" from a nominal anchor-system which does not allow any flexibility in dealing with shocks to a more flexible regime without losing the confidence into monetary stability which was gained under the old system. It seems necessary in this context to take the following steps – irrespective of the existence or non-existence of a currency board:

- build a robust and effective **public sector management system** which provides for high levels of fiscal control and strategic budget prioritization;
- **harden the budget-constraint** with regard to SOEs;
- reform the **tax system** (i.e. with a shift of tax burden from payroll-taxes with its detrimental effect on employment to indirect taxes);
- strengthen the **tax authority** in order to eliminate (as far as possible) the huge tax evasion;
- make the **public procurement** system more transparent and less corruption-prone;
- pursue a **monetary policy** which is primarily oriented towards macroeconomic stability which – after all experience – presupposes an autonomous central bank.

Most of these steps are neutral for the poor or even favour them. But one cannot exclude some negative effects. Higher VAT-rates i.e. reduce disproportionately the real income of those who have a large consumption-rate and these are the poor. There is another problem. In some cases tariffs for public utilities are very low. In Serbia-Montenegro they are "the single largest source of quasi-fiscal deficits"[26]. An adjustment to real costs is unavoidable but it would be detrimental to the poor. There is no easy escape from this **trade-off** between macroeconomic stabilization (which favours the poor in the long run) and poverty-reduction (which becomes more difficult in the short run). What governments can do, is to get as much scope as possible for well targeted income subsidies through a strengthened fiscal revenue- and expenditure-management and to pursue consequently macro-economic stability.

ad c) Competitive markets. - The engine of growth is **private initiative**. Time is over in which the state was considered the "caretaker" for social welfare. The government still has to

[26] *Federal Republic of Yugoslavia* (2001), p. XII.

take some regulative responsibilities within the framework of a “strong but limited state”. But it is well advised not to intervene into markets for private goods and not to dictate what individuals should desire.

On point should be clear. It is so self-evident that it is rarely being mentioned. Private initiative to an extent that is necessary to stimulate economic growth is not given forever and for all. It can (and sometimes it must) be **learned**. The same is true for private **responsibility** and the **willingness to take risks**. Individual mentalities like these are prerequisites for growth and they must be trained. This does not mean that everybody has to become a narrow-minded profit-maximizer. To develop these mentalities means (at least in my opinion which may not be shared by every apologist of a market system): individuals should exercise their best capabilities in a responsible way; they should work for their economic improvement having in mind, that wealth is not the highest value in human life and being economically efficient is not synonymous to happiness. Admittedly this sounds a bit idealistic. But a market economy will degenerate (or not get started at all) if not a certain number of people will act correspondingly: not as ruthless fans of an economic ideology but as responsible men and women who develop their best talents oriented towards their own enlightened understanding of a better life.

What can politically be done in order to develop private economic initiative? The state can provide for the institutions of a **market economy**. In this setting, everyone can act in correspondence to his or her private interests (how enlightened these interests are must be left to every individual) and these actions are being made compatible to each other not by an ex ante planning-process but ex post as a result of competition. This competition-process offers some systemic advantages but it contains specific risks. There is no guarantee that someone gains a “just” reward for his economic effort. “Justice” is no concept which fits into the institutional design of a market economy as *Hayek* told us convincingly[27].

Therefore, establishing competitive markets alone will not contribute to a pro-poor growth. It must be supplemented – I’ll come back to this point. But the need to **complement** competitive markets should not divert from every effort to **establish** them. What does this mean for South-Eastern Europe? Governments of the region still distort private markets in many forms and at

[27] *Hayek* (1976), p. 69; the relationship between “social justice” and the market-system is being discussed in *Sautter/Schinke* (2001).

the same time they are delaying necessary regulations which are prerequisites of a market system.

To take first the governmental **over-activity** in a market-distorting way:

- an **over-complex** and **non-transparent public administration** strangulates many private initiatives;[28]
- small firms suffer from **bureaucratic harassment** (frequent inspections, audits etc.)[29];
- **SOEs** are still **privileged** against private firms;
- **price-regulations** impede an efficient allocation of scarce resources:
- **customs procedures** are over-complex and impede the modernization of the capital-stock.

On the other side, governments are **weak** in establishing the institutional preconditions of market economy:

- the **poor law enforcement** (in combination with an high corruption) contributes to a bad business climate;
- **insecure property-rights** impede private investments;
- the **insufficient protection of creditors** is an obstacle for the development of credit markets;
- **poor regulations** of financial institutions are one of the causes for the wide-spread distrust in these institutions.

The challenges ahead are obvious. Administrative procedures have to be simplified, the privatisation of SEOs should be continued (without the preference to insiders over outsiders including foreign investors as it was practiced in Croatia[30]), property rights have to be strengthened, administrative costs of entering markets should be lowered etc. In one word: governments can do a lot in order to stimulate private initiative and to develop markets.

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[28] Until recently in Moldova it took 150 registration steps to get a license for establishing a private enterprise, *World Bank* (2002), p. 9.

[29] *World Bank* (2003a), p. XX.

[30] *World Bank* (2001), p. XI

2.2. Making the growth-process "pro-poor"

Good governance, macroeconomic stability and competitive markets are good for economic growth which benefits the poor as well as the rich. In order to make the process "pro-poor", growth must be focussed on sectors the poor are working in, on regions the poor are living in and on factors the poor possess or are able to possess[31]. Poverty assessments show that the corresponding sector is agriculture, the relevant regions are mainly rural ones and the factor in question is labour. Therefore, pro-poor growth should disproportionately favour **agricultural production**, non-agricultural incomes in **rural areas**, the demand for **labour** and the endowment with of the poor with "**human capital**".

In order to substantiate this argument we may look to some statistical data. In **Albania** 66 percent of the poorest quintile and 61 percent of the second quintile are rural households. Their main source of income (37 %) is small scale agriculture followed by wage employment (27 %)[32]. **Bosnia-Herzegovina** shows a similar picture. In spite of a low degree of extreme poverty, households in rural areas are especially vulnerable. Moreover, poverty is positively correlated with low educational levels, limited access to health services and unemployment and it is concentrated among internally displaced people and large families. Among households with three and more children below 14, poverty-rate is 56 % or nearly three times higher than the average[33]. Unemployment, low education and living in rural areas are also the main factors of poverty in **Bulgaria.** In addition to that there is an ethnical problem. The Roma are strongly over-represented among the poorest quintile[34]. Pockets of poverty which are ethnically determined are also one of the problems of **Croatia.** Among the poor who mainly live in rural areas the non-Croates are over-represented: Serbs, Albanians, Roma and Bosnian Muslims[35]. In **Macedonia** two thirds of poor households live in rural areas. Here the headcount index is nearly twice as high than in the capital (25% in comparison to 13.9 %[36]). As well as in Bulgaria poverty among the Roma is disproportionately high. The same is true for **Romania.** Three out of five Roma live in extreme poverty and only one out of 5 Roma is not poor[37]. Poverty is concentrated in rural areas and among the unemployed; 45 % of the unemployed are poor. Also in **Moldava** poverty is mainly a rural problem. Alarming is the

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[31] *Dreze/Sen* (1989); *Ravallion/Datt* (2002).
[32] *World Bank* (2003a), p. XIII.
[33] *World Bank* (2003b*)*, p. III.
[34] *World Bank* (2004a), p.2.
[35] *World Bank* (2001), p. VIII.
[36] *Government of the Republic of Macedonia* (2000), p.2.
[37] *World Bank* (2003d), p. II.

fact that one fifth of the poor are children[38]. **Serbia-Montenegro** also suffers from a high poverty in rural areas, among the unemployed and among the poorly educated. To **summarize**: Pro-poor growth should

(a) be focussed on agriculture and on other income-creating activities in rural areas, it should
(b) increase the demand for labour, it should
(c) facilitate the formation of the poor's "human capital", and it should
(d) tackle country-specific pockets of poverty.

ad a) Rural development. – Some countries in South-Eastern Europe suffered from the same "**urban bias**" as most developing countries (*Lipton*, 1977). Policy was made by the cities, in the cities and for the cities. Physical infrastructure in rural areas has been neglected, the rural population has been discriminated with regard to health and educational services, agriculture was taken as a source for financing industrialization and not as a sector which deserves some promotion. This distortion has to be **corrected**. However, one should be cautious and distinguish between short-term necessities and long-term prospects. In the short to medium-term, poverty-reduction will not be possible without productivity-growth in the agricultural sector. In the long run, however, economic prospects are not to be found in this sector but in manufacturing and in services. Even in case of open markets for agricultural products in an enlarged European Union, the future of South-Eastern Europe lies outside agriculture.

This, of course, is no argument for neglecting this sector. On the contrary! Productivity-growth in agriculture must be stimulated, and what is even more important: off-farm employment in rural areas should be promoted[39]. There are many possibilities to do this:

- **land-markets** can contribute to an efficient allocation of agricultural plots;
- **extension services** may help to introduce labour-intensive technologies;
- voluntary **cooperative associations** can facilitate the introduction of modern technologies;
- **infrastructure** can be improved through the rehabilitation and construction of rural roads, bridges etc. which facilitates the access to consumer markets for agricultural products and the procurement of inputs;

[38] *World Bank* (2002), p.5. *Mitev/Stubbs* (2004, p. 49) give an overview on children in absolute and relative poverty in all countries of the region.
[39] This point is stressed in: *CASE* (2004), p. 7.

- **quality standards** for agricultural products can be improved i.e. through establishing institutions for plant health protection and for sanitary services;
- **micro-credit programs** can facilitate farm and off-farm investments[40];
- **off-farm work** in the processing of agricultural products can diversify the sources of incomes and increase the purchasing power in rural areas (wine production, processing of tobacco, wood processing, canning industry, sugar production etc.);
- in some countries there is a high potential for developing **tourism.**

ad b) Increase of the demand for labour.- In all countries unemployment is strongly correlated with poverty. Therefore, the creation of productive employment opportunities is one of the main elements of a strategy for pro-poor growth. These opportunities result from private economic activities so that all efforts to improve the business climate also contribute to a higher employment.

But this is not enough. The demand for labour can be increased disproportionately through the introduction of **labour-intensive technologies.** They can be promoted through tax-incentives (or at least through the avoidance of tax-disincentives in form of tax-brakes and subsidies for capital-intensive technologies). Micro-credit programs and corresponding guarantee funds for **Small Scale Enterprises** (SME) are another form of employment creation as SMEs in general are more labour-intensive than big firms.

In this context, the institutional design of **labour markets** is of special importance. Rigid regulations which protect job owners against job-seekers, a low degree of wage flexibility and open discrimination[41] are deficiencies which characterize the labour markets in many countries. Reforms, therefore, are indispensable. They have to be oriented towards a higher flexibility of wages, the elimination of all forms of discrimination (gender-discrimination, ethnic discrimination), an improved matching process, lower payroll taxes[42] etc. The elimination of unnecessary regulations also facilitates the transition from informal to formal employment with its higher potential for productivity-increases.

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[40] One should not over-emphasize these programs. By and large they benefit not directly the poorest sections of rural population, the landless and those farmers with very small plots. Nevertheless, productivity increases induced by micro-credit programs create an additional demand for labour-intensive services which may be offered by the poor.
[41] This is a special problem in Croatia; *World Bank* (2001), p. XIII.
[42] In Romania unusually high payroll taxes at 52 percent of gross wages are partly responsible for high unemployment rates; *World Bank* (2003d), p. IV.

Romania made some experience with **active labour market policies:** the programs for training and retraining (TR), small business consultancy and assistance (SB), employment and relocation (ER) and public works community job creation. (PW). The experience was mixed. The first three of these programs had positive employment effects, SB and ER also influenced positively the monthly earnings of participants, whereas PW could not be considered as successful. This is not astonishing in view of the experiences of other countries. The conclusion which can be drawn from the Romanian results seems to be, that initiatives for training and retraining as well as those for consultancy and assistance are the most promising ones[43]. They are not only oriented towards the demand side of labour markets, but also (and primarily) towards the supply side. This is also the focus of programs for human capital-formation.

ad c) Initiatives to improve the "human capital" of the poor. – Poverty assessments for all countries of the region show, that poverty is strongly correlated to a low level of education and to a bad state of health. The relevant causalities are double-sided. An unfinished primary education and the missing access to health services are causes of poverty, and poor people cannot afford to pay for a better education and better health services. **Circular causalities** like this are being passed to the next generation. Poverty, therefore, becomes a chronic phenomenon. In Romania i.e. 39% of children aged 15-24 living in poor households are not in school and did not attend vocational or high school; this compares to 10% for non-poor children of the same age group[44]. This makes it even more important to invest into the human capital of the poor. In general, better educated adults earn more, they have better chances to get an employment and they can offer a better education to their children than poorly educated adults can[45].

The political priorities do not correspond to the importance of human capital formation. In Albania i.e. public spending on education has fallen to levels almost half of what it was in

[43] *World Bank* (2003d), p.40.
[44] op. cit., p. III.
[45] There are exceptions. In Moldova, for example, among the poor are highly educated persons who once (before transformation began) "enjoyed socially prestigious and well compensated positions as scientists and professionals" (*World Bank*, 2002, p. 5). These are unsolved problems of the transformation process. The existence of highly educated poor people is no argument against a better education for the poor. It merely shows that education cannot be isolated from the macroeconomic and political environment. If growth rates are negative and public as well as private expenditures for scientific purposes decline, a highly specialized knowledge may not protect from poverty. But in an environment of high growth rates, increasing public revenues and expenditures and functioning scientific institutions, to be well educated is the best precondition to get a well-paid job. In Romania, for example, "post-secondary and higher education of household head almost were fully absent from the poverty figures", *CASE* (2004), p. 7.

1990[46]. In Moldova it declined from 10% of GDP in 1997 to 4.5% in 2000[47]. In these as in other countries enrolment rates went down, drop out rates increased (especially at the secondary school level), curricula are out of date and do not correspond to the requirements of a modern market economy. In one word: It seems that exactly those **investments** have been seriously **neglected** which are decisive not only within a strategy of poverty reduction but also within a strategy for economic growth in general[48].

The importance, therefore, of a new education policy cannot be overstressed. It should include the following elements:

- Availability of **pre-school education** for poor children who need it most to offset their relatively deprived background;
- review of **curriculum standards**;
- reform of the curricula of **secondary** and **professional schools** in view of the requirements of the labour market;
- establishment of a **participatory education system** through the creation of social partnership mechanisms involving the family, the school and the local community;
- **scholarship programs** for talented poor children;
- development of **out-of-school training**;
- lower barriers for the establishment of **private schools**;
- better **school-equipment**, especially in rural areas, better systems of **teacher-training** and an **attractive payment** for teachers.

The other element of a human capital-strategy is **health policy**. Individual health and education standards are strongly connected: Healthy children usually show better results at school and high levels of education usually go hand in hand with illness-preventing hygienic- and nutrition-standards. Therefore, health- and education policies should not be separated: the success on one field decides upon the success on the other one.

The main problem is the **limited access** of the poor to health services. Usually health stations, hospitals, medical doctors etc. are concentrated in the cities and not in rural areas where the

[46] *World Bank* (2003a), p. XVI.
[47] *World Bank* (2002), p. 12.
[48] Growth of any variety is higher in countries with sufficient human capital; *Barro* (1991); *Mankiw/Roemer/Weil* (1992).

majority of poor people live. Moreover, in many cases medical **costs** are **prohibitively high**. The consequence is a poverty-trap: The poor suffer from a bad state of health, therefore their earning capacity is limited and this makes it impossible for them to overcome their poverty. In addition to that, underdeveloped and non-accessible health services make those people very vulnerable, who earn just a bit more than the minimum income. If they fall ill, their risk is very high to sink below the poverty-line.

The main challenge, therefore, is to improve the access to qualitatively high health services for the poor. It can be done, for example, by

- establishing a **mandatory health insurance system** (which is compatible with competition between various insurance companies);
- establishing and upgrading of **rural dispensaries, maternity units** etc.;
- the **hygienic education** of poor families including issues of **family planning** (poor families in general are large families);
- new **priorities for health ministries** (which until now focussed their activities to the middle- and upper class and to urban areas).

ad d) Initiatives to tackle the pockets of poverty.

Obviously, this is the most difficult task in every strategy for pro-poor growth. In some areas and among certain ethnic groups, poverty in its extreme forms has been chronic for many generations. Take for example the Roma who constitute a substantial part of the population in Bulgaria (8.9%), Romania (9.4%) and Macedonia (10.9%)[49]. Other examples are some remote rural areas in Albania, Romania amd Bulgaria. It would be an illusion to eliminate these pockets of poverty within on generation. But also these forms of chronic pauperization can be alleviated. One thing should be clear, though: Competitive markets alone cannot solve the problem. Governmental initiatives are indispensable – if it is a political goal at all to tackle these poverty-niches.

Principally, all **measures** described above can alleviate this form of poverty if they are **focussed** on the pockets in question: improved health services, better access to schools, agricultural extension services, infrastructure investments, off-farm employment etc. in

[49] *Mitev/Stubb* (2004), p. 65.

remote rural areas and in favour of ethnic groups living in extreme forms of poverty. A precondition is the elimination of all forms of ethnic discriminations and of a deeply-rooted "**urban bias**". It is not sufficient to change some laws. Mentalities, ways of thinking and attitudes have to be changed, too, and this takes much more time than passing new laws.

In view of existing discriminations one should **avoid** any further **marginalization** of poor ethnic groups. It could undesirably result from a targeting process along ethnic boundaries. Therefore, it may be advisable to target poverty-alleviation measures to "communities where Roma are over-represented rather than singling out Roma explicitly"[50]. This point was made in view of Romania. It indicates how delicate it is to tackle pockets of poverty without stirring up the resistance of the non-poor.

Another point deserves to be mentioned. For some rural areas, **migration** to other regions may be the only realistic way to solve the problem. Take the mountain-region of Albania as an example. The average land size owned by a household is around 0.72 hectares. In addition to that, climatic and geographical conditions are very hard which makes it difficult to increase agricultural productivity in a substantial way.[51] Possibly the poverty of people still living there can only be eliminated if these people migrate. Already now in this country "migration is perhaps the single most important political, social and economic phenomena"[52].

3. Conclusions

The considerations in section 2 suggest the following conclusions:

First, pro-poor growth cannot be expected from a development which is governed by competitive markets alone. In a market economy which works within the framework of some kind of "minimal state", the poor will benefit disproportionately less from growth and distributional inequality will increase. In other words: growth will be "pro-rich" as it was within the past 10 years in all countries of the region.

Second, to get a disproportionate higher benefit from economic growth to the poor, it needs a bundle of well-targeted political measures. They have to include specific programs for rural

[50] *World Bank* (2003d), p. II.
[51] *World Bank* (2003a), p. XIII.
[52] op. cit. p. XVIII.

development, for the stimulation of small and medium-sized enterprises, for employment-generation and for a better access of the poor to education and health-services.

Third, these measures have to be planned and executed in a consistent way without undermining the conditions of overall economic growth. In most cases this should be possible, at least on a theoretical level. Measures to improve the education and the health of poor people and to increase their labour-productivity automatically stimulate overall growth. Insofar, these measures constitute a “win-win”-constellation. Nevertheless, there are trade-off-situations. Some measures which favour the poor may undermine macro-economic stability and the efficiency of resource-allocation (i.e. price-regulations and subsidies for public utilities). From an economic point of view, it is desirable not to intervene into the price-mechanism and to materialize social goals through fiscal instruments. But the best policy from an economic point of view may not be practicable. In these cases, politicians have to balance between a long-term and a more short-term poverty-alleviation. In the long run, a stable and efficient economic system without price-distorting subsidies offers good conditions for poverty-alleviation, but eliminating these subsidies may be detrimental to the poor in the short run.

Fourth, a well-designed strategy for pro-poor growth depends on the decisiveness of politicians as well as on the capabilities of public administration. It is hard to imagine, that a strategy like this will be materialized without giving the poor “voice” to influence the institutions and policies that affect their lives.

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Table 1: Gini-Coefficients for Bulgaria and Romania

Country	Year	Coef.	Year	Coef.	Year	Coef.	Year	Coef.
Bulgaria	**1989**	21,7	**1993**	33,1	**1997**	34,1	**2000**	37,1
Romania	**1989**	23,3	**1994**	28,6	**1997**	30,5	**2002**	32,0

Source: http://www.centreurope.org/panoramagb/gini_coefficient_central_eastern_europe.htm

Gini index measures the extent to which the distribution of income (or, in some cases, consumption expenditure) among individuals or households within an economy deviates from a perfectly equal distribution. A Lorenz curve plots the cumulative percentages of total income received against the cumulative number of recipients, starting with the poorest individual or household. The Gini index measures the area between the Lorenz curve and a hypothetical line of absolute equality, expressed as a percentage of the maximum area under the line. Thus a Gini index of 0 represents perfect equality, while an index of 100 implies perfect inequality.

Table 2: Annual Freedom in the World Country Scores, Civil Liberties

Year covered	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
Albania	6	4	3	4	4	4	4	4	5	5	5	4	3	3
Bosnia-Herzegovina	..	..	6	6	6	6	5	5	5	5	4	4	4	4
Bulgaria	4	3	3	2	2	2	3	3	3	3	3	3	2	2
Croatia	..	4	4	4	4	4	4	4	4	4	3	2	2	2
Macedonia	..	..	4	3	3	3	3	3	3	3	3	4	3	3
Moldova	..	4	5	5	4	4	4	4	4	4	4	4	4	4
Romania	5	5	4	4	3	3	3	2	2	2	2	2	2	2
Serbia and Montenegro	4	5	5	6	6	6	6	6	6	5	4	3	2	2

Source: Freedom House (2004)

Civil liberties are measured on a one-to-seven scale, with one representing the highest degree of freedom and seven the lowest.

For Yugoslavia, ratings from 199 to 2002 were for the country that remained following the departures between 1991 and 1992 of Slovenia, Croatia, Macedonia and Bosnia-Herzegovina. In February 2003, the Yugoslav parliament adopted a constitutional charter establishing the state of Serbia and Montenegro. Thus, beginning in 2003, Yugoslavia is listed as "Serbia and Montenegro."

Table 3: Corruption Perception Index (CPI)

Country	Rank (133 countries)	CPI 2003 score
Bulgaria	54	3.9
Croatia	59	3.7
Bosnia & Herzegovina	70	3.3
Romania	83	2.8
Albania	92	2.5
Moldova	100	2.4
Macedonia	106	2.3
Serbia & Montenegro		2.3

Source: Transparency International (2004)

CPI 2003 Score relates to perceptions of the degree of corruption as seen by business people, academics and risk analysts, and ranges between 10 (highly clean) and 0 (highly corrupt).

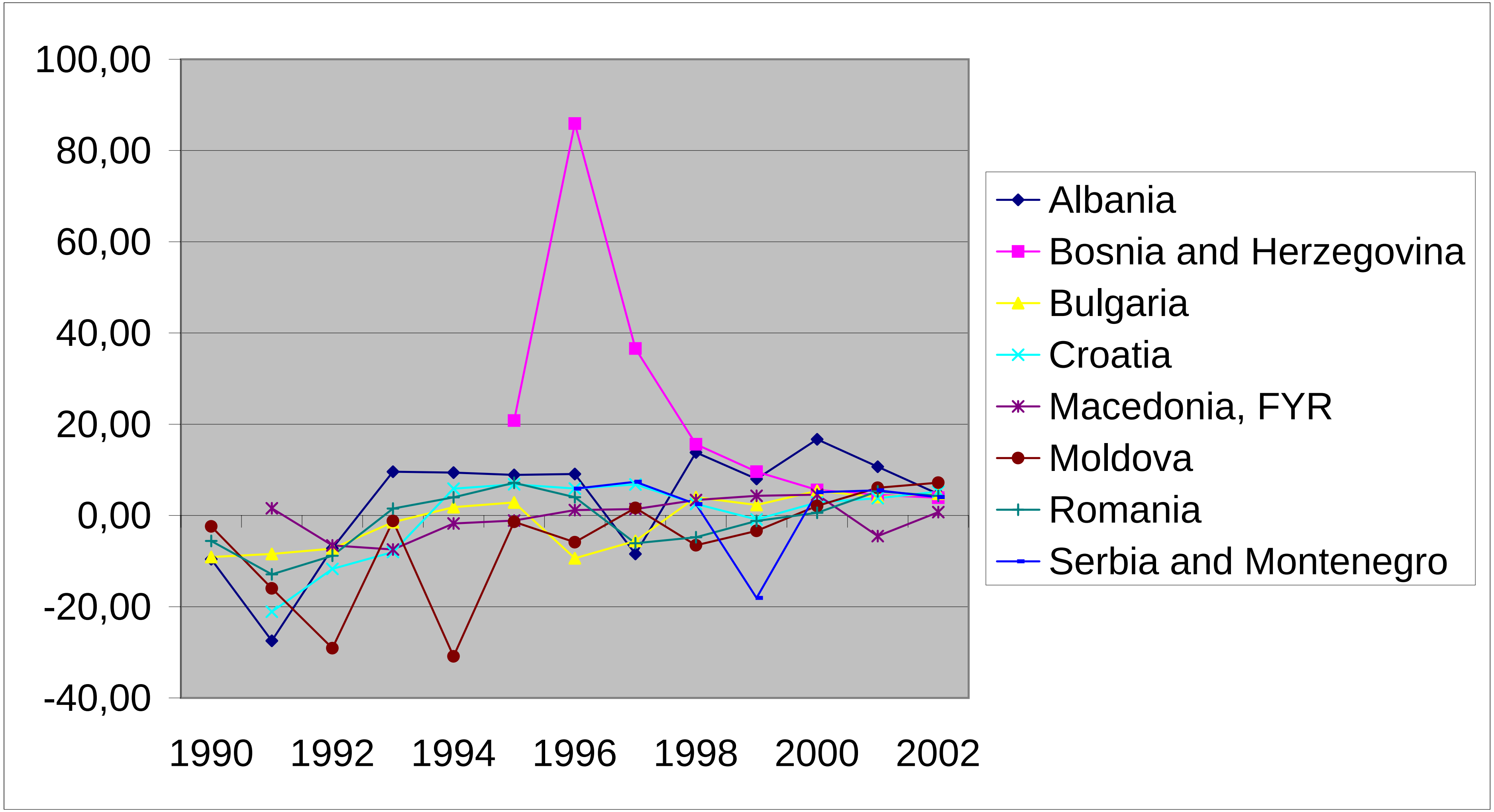
Table 4: Inflation, GDP Deflator (annual %)

Country	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
Albania	-0,469	34,54	249,7	114,8	37,02	9,839	28,42	11,75	12,45	6,507	-4,085	3,891	6,035
Bosnia and Herzegovina						8,847	-17,06	8,553	6,913	3,842	5,792	9,115	2,113
Bulgaria	26,19	226,6	59,59	51,08	72,67	62,85	120,8	948,5	23,67	3,722	6,691	6,711	3,859
Croatia		99,33	594,9	1467	111,8	5,315	3,642	7,36	8,404	3,783	4,735	2,932	2,919
Macedonia, FYR		78,98	1272	442,1	151,9	17,09	2,865	3,971	1,37	2,759	8,178	3,611	3,584
Moldova		142,8	945	860,5	276,4	38,74	27,85	12,5	9,462	39,78	27,33	11,93	8,1
Romania	13,6	194,9	200,1	227,4	138,9	35,24	45,17	147,3	55,22	47,77	46,41	37,91	24,22
Serbia and Montenegro							69,01	32,39	34,24	60,94	88,28	91,66	25,47

Source: World Bank (2004)

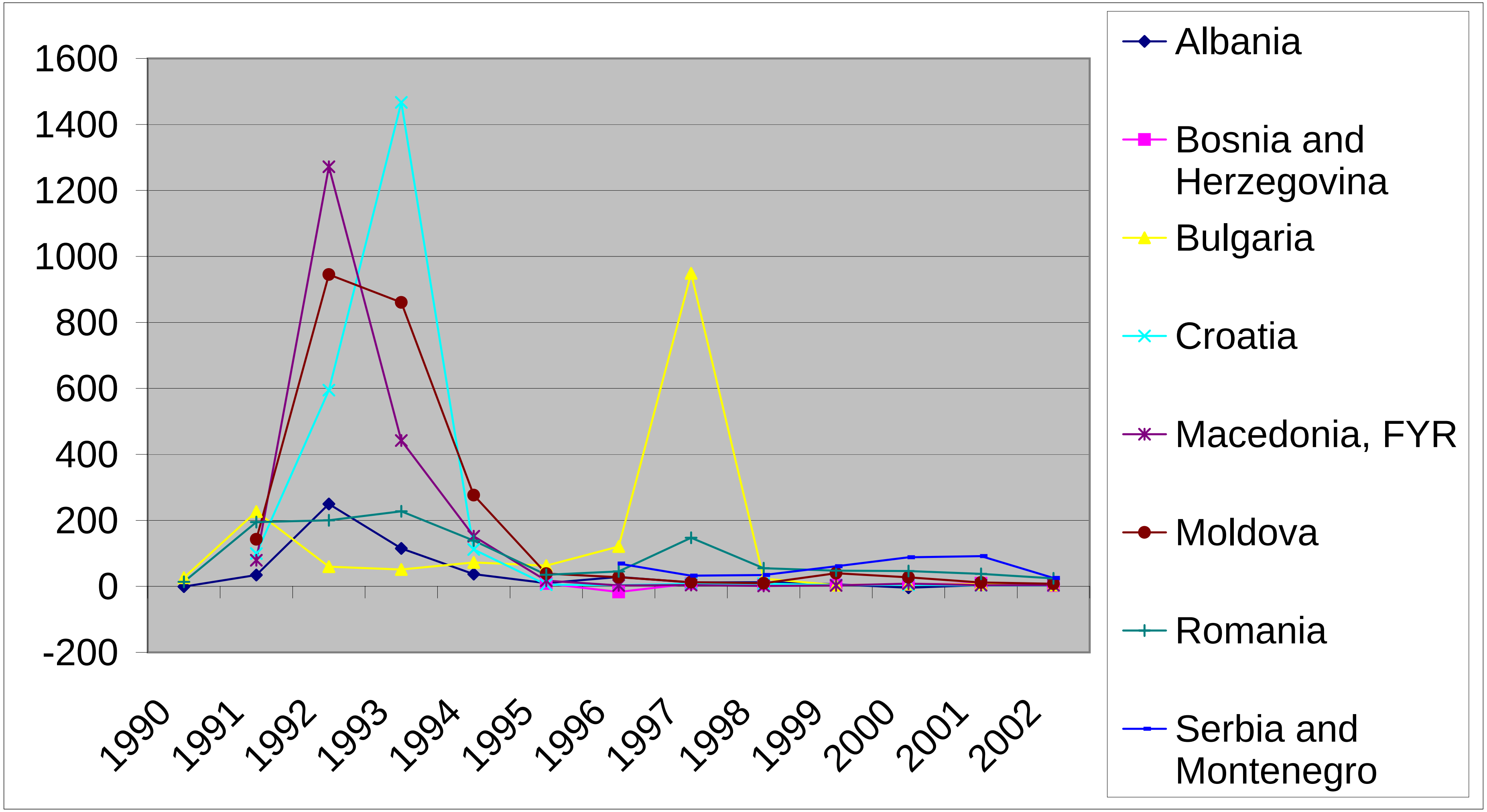
Inflation as measured by the annual growth rate of the GDP implicit deflator shows the rate of price change in the economy as a whole. The GDP implicit deflator is the ratio of GDP in current local currency to GDP in constant local currency.

Figure 1: GDP Growth (annual %)



Source: World Bank (2004)

Figure 2: Inflation, GDP Deflator (annual %)



Source: World Bank (2004)